

## PUBLIC FINANCE MANAGEMENT BOARD

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Date: December 16, 2005

To: Honorable Chair and Members of the Public Finance Management Board

From: Joan M. Caine, Deputy Treasurer for Finance  
Paul Goslin, Debt Analyst

Subject: Public Finance Management Board ("PFMB")  
Debt Report Update: Rhode Island's Local Government Debt

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On April 28, 2005, the PFMB published its annual Report on Debt Management ("State Debt Report"). This State Debt Report provides a comprehensive review of State, State Agency and Quasi-Public Corporation debt. According to **R.I.G.L. §42-10.1**, the PFMB's comprehensive annual debt review is to also include an analysis of the State's local governmental unit debt. This memorandum provides the required summary analysis of the debt profiles of Rhode Island's cities and towns.

Rhode Island's high level of State debt is partially the result of certain governmental functions being assumed at the State level, which in other states might be delegated to the local governmental level. Examples of this include the State's convention center and correctional facilities. This argument implies that Rhode Island's local governments should be relieved of a relatively heavy debt burden. This continues to be true for the majority of Rhode Island cities and towns.

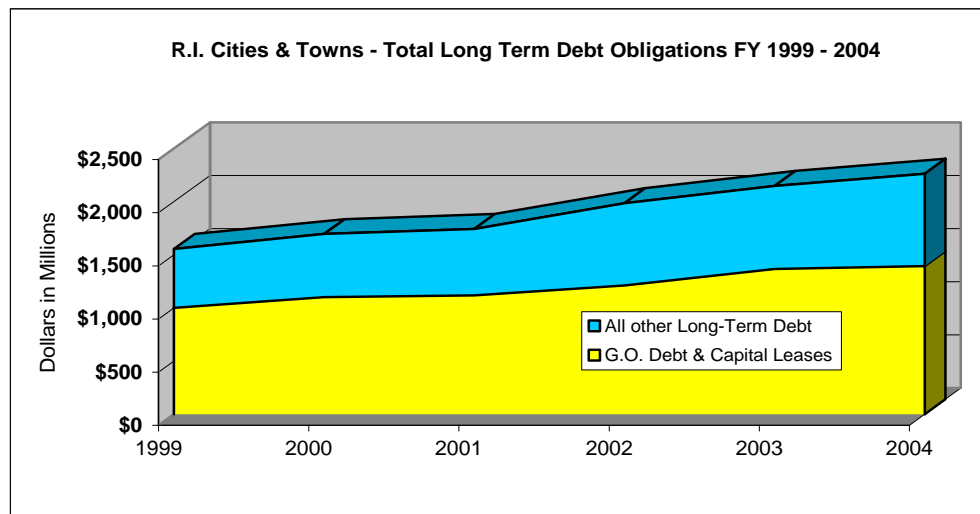
Staff recommends that the PFMB continue to monitor the growth of local governmental debt and Treasury staff will publish a local government debt report biannually.

The principal findings of this report are summarized below:

### ***Growth of Long-Term Obligations of RI Cities and Towns is Accelerating***

As shown in the following graph, total long-term obligations have increased from \$1.56 billion in 1999, to \$2.26 billion in 2004, which represents an annual compound growth rate of 6.45%. General obligation (G.O.) debt and capital leases, which comprise the largest components of total long-term debt, increased by \$393.4 million from a total of \$1.0 billion in 1999 to \$1.39 billion in 2004. R.I. cities and towns total G.O. debt and capital leases compound annual growth rate of 5.68% is in contrast to the State's declining rate of debt (-2.52%) and exceeded the 3.75% growth rate of RI's personal income over this period. The local governments with the fastest compound annual debt growth rates since 1999 include Tiverton (53.5%), Coventry (40.6%), Woonsocket (33.2%) and Newport (21.5%). In terms of absolute dollar growth, several cities and towns have added significantly to their outstanding debt in the last five years. These include the following cities: Providence

(+\$184.7 million), Woonsocket (+\$99.6 million), Coventry (+\$37.7 million), Cranston (+\$29.1 million) and North Kingstown (+\$29.0 million). Over the same period, thirteen municipalities have reduced outstanding debt, most notably, Pawtucket (-\$67.1 million) and Lincoln (-\$13.8 million).



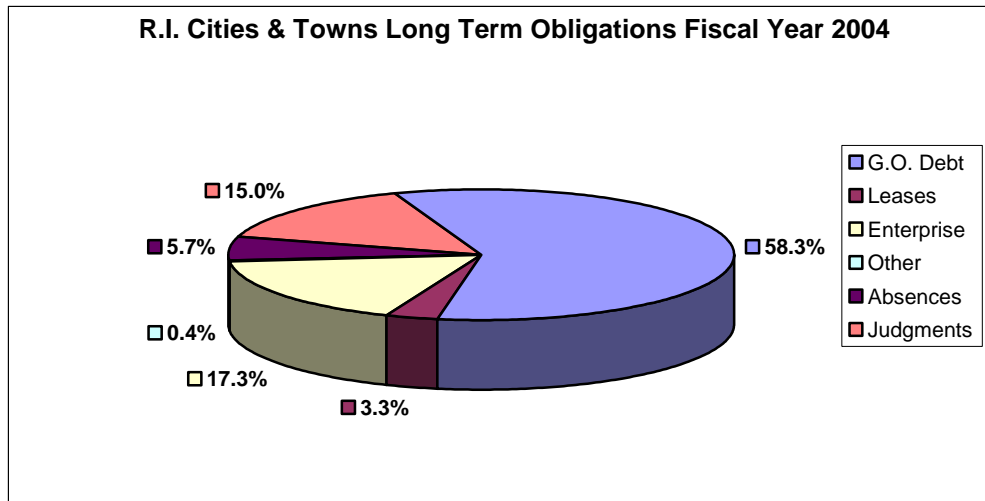
As expected, the local governments with the most G.O. and capital lease debt include the State's largest cities, such as Providence (\$471.9 million), Woonsocket (\$121.2 million), Cranston (\$72.6 million), Warwick (\$67.9 million) and Pawtucket (\$57.8 million). The communities with the lowest debt levels outstanding include West Greenwich (\$120,225), Foster (\$307,545) and Hopkinton (\$1,704,878).

Investment in infrastructure, such as schools, roads and water supply systems and community development may be the reason for growth in debt levels. It should also be noted that debt growth rates might appear to be high for certain cities or towns because they may have had minimal amounts of G.O. debt and capital leases outstanding in 1999. The town of Tiverton, for example, had outstanding G.O. debt and capital leases in 1999 of only \$670,375 (see Appendix B). An increase from such a nominal level of debt outstanding would necessarily show a high rate of growth, but might not necessarily be a significant increase in absolute dollars. For this reason, it is important to look at absolute dollar growth, as well as the annual growth rate of debt.

Analysis of debt levels relative to population trends is also important. Estimates provided by the Rhode Island Division of Statewide Planning for 2004, versus the official (actual) 2000 U.S. Census figures, do not provide insight as to population growth, as these estimates indicate a compound annual growth rate of only 0.61%. Analysis of building permit growth in cities and towns would be an indicator of the need for infrastructure and therefore additional debt. However, this consideration is beyond the scope of this analysis.

### ***General Obligation Debt Accounts for 58.3% of Total Long-Term Obligations***

The definition of long-term obligations has been expanded in recent years to include unfunded judgments, claims and accrued pension liability as well as accrued vacations, absences and deferred compensation along with G.O. bonds, loans and notes, and capital leases. As shown in the chart below, most long-term obligations consist of G.O. bonds, loans and notes payable (\$1.32 billion or 58.3% of total debt) approved by voter referendum. The second largest category at 17.3% is enterprise fund debt (\$391.3 million), which typically is self-supporting, followed by unfunded claims, judgments and accrued pension liability debt at 15.0% (\$339.9 million). Absences, vacations and deferred compensation, represent 5.7% of long-term obligations and capital leases represent 3.3%. Finally, other debt, (\$9.7 million), includes items such as provision for landfill closure costs, special purpose bonds or other types of debt.



Statewide figures for non-general obligation debt are somewhat skewed, as a handful of cities and towns comprise the majority of this type of debt. The City of Warwick accounts for 34% of all outstanding enterprise fund debt, while Pawtucket has 18% of all enterprise debt. Providence represents 37% of the unfunded claims, judgments and accrued pension liability, followed by the City of Cranston (26%) and Pawtucket (15%). In light of the fact that non-general obligation debt is self-supporting, only General Obligation debt and Capital Leases are included in the comparative debt analysis, with one exception described in the footnotes in Appendix B.

### ***Tax-Supported Debt Capacity Ratios***

Treasury obtained summary financial data from the FY99-04 audited financial statements of each city and town. The FY04 audited financial statements are the most current available for all cities and towns. Population figures are based on the official 2000 census figures from the U. S. Census Bureau, Washington, D.C. and the R.I. Division of Statewide Planning. Property valuations are based on the equalized weighted assessed full valuations of each city and town, averaged from 2000 - 2002.

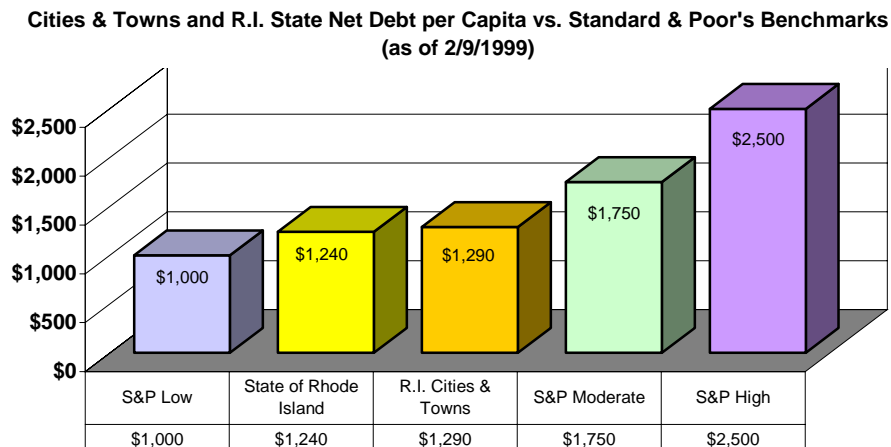
In general, population and property valuation data may lag actual conditions by several years. Despite the lag in available data, it provides a relevant analysis that allows for comparative debt ratio analysis.

To analyze the relative debt burden for cities and towns, we examined debt ratios, which revealed the following:

### ***Tax-Supported Debt Per Capita on the Rise***

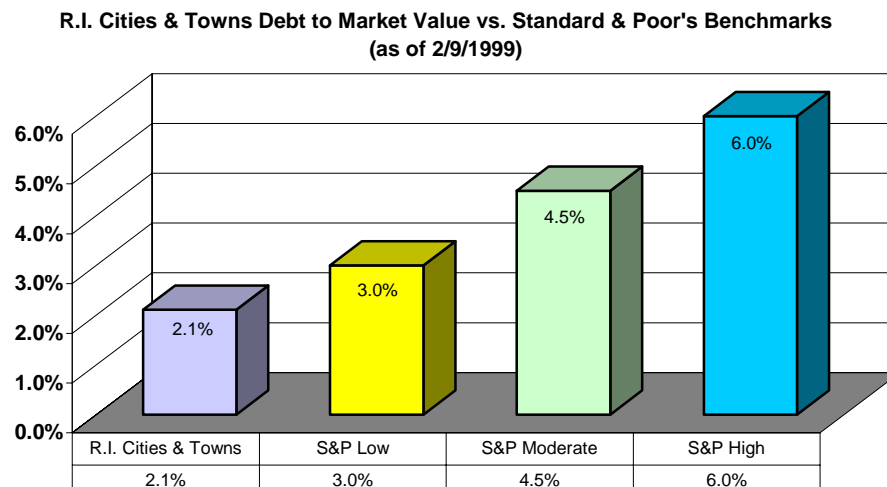
As shown in the chart below, the average debt per capita for RI's cities and towns is \$1,290, (up from \$1,006 in 2002), which is categorized by Standard and Poor's as "moderate" debt burden. In prior years R.I. cities and towns were categorized as having a "low" debt burden. The cities and towns with the highest debt per capita include areas of the state with relatively low population, such as New Shoreham (\$8,645) and Exeter (\$1,880). However, relatively high population does not necessarily mean low debt per capita. Two cities with high absolute debt also had high debt per capita relative to the other communities: Woonsocket (\$2,722) and Providence (\$2,649). The communities with the lowest debt per capita were West Greenwich (\$21), Foster (\$68) and Hopkinton (\$210). The towns of Foster and West Greenwich participate in a regional school district, which shares school debt with other communities.

S&P's benchmarks for Debt per Capita along with R.I. Cities and Towns debt levels are shown in the graph below.



***Tax-Supported Debt as a Percent of Property Valuation Compares Favorably to S & P Benchmarks***

Debt as a percent of property valuation is a measure often cited by the rating agencies as an indication of ability to incur indebtedness. However, because of a ten-year property revaluation cycle, property valuations in Rhode Island communities often do not reflect the true market value of taxable real estate. For this reason, staff has attempted to measure property wealth through the equalized weighted assessed full valuation, averaged over a three-year period 2000 - 2002. The Rhode Island Department of Administration, Office of Municipal Affairs provided property valuation figures. Taking this property valuation estimate as a percentage of outstanding debt reveals that the statewide average is 2.11%, well below the S&P benchmark range of 3.0% - 6.0%. Woonsocket (14.3%), Providence (13.1%) and Central Falls (10.0%), carry the highest debt burden by this measure. West Greenwich (0.02%), Foster (0.09%) and Little Compton (0.21%) have the lowest ratios. The equalized weighted assessed valuation is adjusted for the median family income in each city and town. Therefore, it is not directly comparable to the S&P market value calculation; however, it provides a closer comparison than the actual assessed valuation. S&P's benchmarks for overall net debt to market value as compared to the Rhode Island Cities and Towns debt to equalized full valuation are represented in the chart below.



### ***Tax-Supported Debt as a Percent of Adjusted Gross Income is within PFMB Guideline Range***

Personal income is often compared to debt as a measure of affordability. However, personal income is tracked by the federal government by region, not by city or town. For this reason, the Rhode Island Division of Taxation extracted information from the State taxation database to determine the level of reported adjusted gross income by city and town for 2003. Treasury staff then computed the ratio of local debt to adjusted gross income. The statewide average increased slightly from 4.7% in 2002 to 5.3% in 2004. The State's net debt to personal income ratio was 3.8% in FY04, well within the PFMB's guideline range of 5% to 6%. The cities and towns with the highest ratios included Woonsocket (22.9%), New Shoreham (22.5%) and Providence (18.0%). The cities and towns with the lowest ratios included West Greenwich (0.1%), Foster (0.3%) and Hopkinton (1.0%).

### ***Debt Burden of Cities and Towns***

From the data obtained, all Rhode Island cities and towns were analyzed based on six debt factors. Three of the factors were based on FY 04 financial statements and three were based on growth from FY 99-04. Please see Appendix A. The debt factors include:

***Net Debt Growth by Net Dollar Change*** - examines the increase or decrease in the total long-term debt on an absolute basis.

***Net Debt Compound Annual Growth Rate*** - examines the rate of increase or decrease in the amount of long-term debt on a percentage basis.

***Debt as a Percentage of Equalized Weighted Assessed Valuations*** - ranks long-term debt as a percentage of the assessed property values. Because property valuation is not standardized across the State, a three-year average from 2000 to 2002 was used.

***Dollar Change in Debt per Capita*** - examines the increase or decrease in the amount of debt for each city or town divided by the population.

***Debt as a Percentage of Adjusted Gross Income*** - determines debt affordability based on the income of tax paying residents.

***Debt per Capita*** - total long-term debt of each city or town divided by the population.

The results are included in Appendix A. Reasons underlying individual municipal debt profiles and growth rates of these communities require further analysis.

Economic growth typically requires added public investment in the form of debt for infrastructure improvements. Also, certain cities and towns may be infrequent borrowers, which might serve to spike the results upward, if considered within a limited time frame and the city or town in question has recently financed a major project (between 1999 and 2004, for example). In addition, special circumstances not explained by the rankings would include bonds issued for tax synchronization.

Finally, as we have demonstrated in this study, a relatively high local government debt burden in Rhode Island does not necessarily mean an unmanageable debt burden relative to cities and towns in other states. In fact, Moody's and S&P have consistently rated the communities ranked among the highest local government debt burdens in the category of "average to above average ability to meet debt service payments" – "Baa/BBB" and "A" category.

### ***Other Categories of Long-Term Obligations on Upward Trend***

While not considered G.O. debt, long-term obligations include absences, vacation and deferred compensation, as well as unfunded claims, judgments and accrued pension liabilities. Our data indicates that the 2004 total impact of these obligations was \$468.6 million, which is 20.7% of the total of all long-term obligations. This represents a 63.2% increase from 1999 when these obligations totaled \$287.1 million or 18.5% of all long-term obligations. The Cities of Cranston and Central Falls have a disproportionate share of their total long-term debt categorized as unfunded claims, judgements and accrued pension liability at 50.5% and 51.7% respectively. The total of all non-general obligation debt has increased from \$555.3 million or 35.7% of total long-term debt in 1999 to \$869.7 million or 38.4% of total long-term debt in 2004. While significant, staff was unable to discern any particular growth pattern associated with the total of these liabilities.

### ***Conclusion***

The average debt per capita for Rhode Island's cities and towns is in the moderate range based on S&P's benchmarks for local government debt, while the percentage of debt to property valuation for Rhode Island's cities and towns is much lower than S&P's benchmarks. For this reason, this analysis validates by quantification at least one of the State Debt Report explanations for relatively high State debt. However, it should be noted that (1) debt growth rates are not uniform across Rhode Island local governments; (2) other long-term obligations also have a significant financial impact on Rhode Island's cities and towns; and (3) the compound annual growth rate of total long-term local government debt (6.5%) is more than two and one-half times the rate of inflation (2.4%) as measured by the consumer price index (CPI) for the Northeast during the period 1999 – 2004. These three factors should be of continuing interest to the Board, as the financial condition of cities and towns has a substantial, if indirect, impact on the state government.

This supplemental report is intended to further the PFMB's compliance with **R.I.G.L. §42-10.1**.

Treasury extends its thanks to the Division of Taxation, the Office of Municipal Affairs, the Division of Statewide Planning and the State's financial adviser, First Southwest Company, for their help in gathering the statistical data used to compile this report.

#### **Attachments**

Appendix A	Ranking of RI Municipalities Based on Six Debt Factors
Appendix B	City and Town Financial Data
Appendix C	Description of RI Property Valuation Methodology
Appendix D	Standard and Poor's Benchmark Report
	Fitch's Local Government Report
	Moody's Special Comment – Moody's Public Finance Group 2004
Appendix E	RI Municipal Credit Ratings